

DEPARTMENT OF THE INTERIOR**Minerals Management Service****30 CFR Part 203****RIN 1010-AD01****Relief or Reduction in Royalty Rates—Deep Gas Provisions****AGENCY:** Minerals Management Service (MMS), Interior.**ACTION:** Notice of proposed rulemaking.

SUMMARY: We (MMS) propose provisions for suspension of royalties for leases in shallow water on production associated with deep gas drilling. For a lease in the Gulf of Mexico (GOM), the proposed rule specifies the location, timing and depth of exploration and production that qualifies the lease for royalty suspension in connection with drilling for gas in deep reservoirs. Also, we propose price thresholds above which royalties must be paid even though production may otherwise qualify for royalty suspension.

DATES: MMS will consider all comments we receive by May 27, 2003. We will begin reviewing comments then and may not fully consider comments we receive after May 27, 2003.

ADDRESSES: If you wish to comment, you may mail or hand-carry comments (three copies) to the Department of the Interior, Minerals Management Service; Mail Stop 4024; 381 Elden Street; Herndon, Virginia 20170-4817; Attention: Rules Processing Team (Comments). If you wish to e-mail your comments, the address is rules.comments@MMS.gov. Reference "AD01—Deep Gas Provisions" in your subject line. Include your name and return address in the message and mark it for return receipt.

Mail or hand-carry comments with respect to the information collection burden of the proposed rule to the Office of Information and Regulatory Affairs; Office of Management and Budget; Attention: Desk Officer for the Department of the Interior (OMB control number 1010-NEW); 725 17th Street, NW.; Washington, DC 20503.

FOR FURTHER INFORMATION CONTACT: Marshall Rose, Chief, Economics Division, at (703) 787-1536. In addition, MMS will hold a workshop in Houston, Texas within the comment period of the rulemaking, to explain various aspects of the rule described in the next several sections. We will announce the workshop location and date on the MMS Web site <http://www.mms.gov>.

SUPPLEMENTARY INFORMATION: Title 30 CFR part 203 regulates the reduction of oil and gas royalty under 42 U.S.C. 1337(a)(3). Under § 1337 (a)(3)(B), we may reduce, modify, or eliminate royalties on certain producing or non-producing leases or categories of leases to promote development or increased production or to encourage production of marginal resources, in the GOM west of 87 degrees, 30 minutes west longitude.

Background

This royalty suspension initiative strives to accelerate natural gas exploration, development, and production from wells drilled to deep depths on existing shallow water (less than 200 meters) leases. We define deep depths either as 15,000 feet or deeper, true vertical depth, below the datum at mean sea level (TVD SS) when a well is completed and produces from a reservoir entirely below that depth, or as 18,000 feet TVD SS when a well without completions penetrates a reservoir target entirely below that deeper depth. To date, less than 5 percent of all wells ever drilled in the 50-year history of OCS production have been to depths 15,000 feet TVD SS or deeper. The historical trend shows a relatively constant rate of recent deep drilling activity:

Number of boreholes drilled TVD SS>15,000 ft in water depths between 0–200 m

Year	1985	1986	1987	1988	1989	1990	1991	1992	1993
Number Wells Drilled	76	32	47	50	41	41	40	34	57
Year	1994	1995	1996	1997	1998	1999	2000	2001	2002
Number Wells Drilled	70	63	67	75	60	59	94	94	74

Natural gas provides about one-fourth of the annual United States energy consumption. Approximately one-fourth of domestic natural gas is produced in Federal waters of the GOM. The National Petroleum Council forecasts that demand for natural gas will increase by 30 percent in the United States over the next 10 years. Yet, since the mid-1980's annual gas production from the OCS has exceeded additions to proven reserves each year. (Four-fifths of OCS production is currently derived from leases located in shallow water). As a result, total proven natural gas reserves on the GOM OCS have declined dramatically from nearly 46 trillion cubic feet (TCF) in 1986 to approximately 24 TCF in 1999. [Estimated Oil & Gas Reserves, Gulf of Mexico Dec. 31, 1999, OCS Report MMS 2002-007].

While the Energy Information Administration (EIA) natural gas price forecast falls below recent levels, supply may be overestimated because EIA assumptions may not fully reflect current projections regarding gas production from deepwater fields and the decline in conventional shelf gas from currently producing leases. Higher prices reflecting market concern in part have already been evident, spiking over \$8 per million British thermal units (Btu) on the NYMEX Henry-Hub during the winter of 2000–2001. Such price volatility can result in higher consumer gas expenditures, while uncertain prices could contribute to under-investment in technologies for deep gas development. Although sustained high gas prices could encourage an increase in deep gas investment, the price fluctuations experienced over the last few years (ranging from \$2.00–\$8.00/mmbtu)

contributes to a climate of uncertainty, thereby inhibiting continuing, stable investment in deep gas development. By providing royalty relief, we could dampen these effects through encouraging timely and profitable deep gas production.

Over the past 6 years, we implemented several royalty incentive programs in deep water. However, because of the long lead times associated with deepwater activity, it could be many years until deepwater production becomes a major contributor, resulting in a significant decline in OCS production of natural gas over the next 5 to 10 years. Additionally, deep drilling incentives for shallow water leases issued after 2000 cover only a small portion of the deep gas potential. Production from deep wells on existing leases in shallow water, where significant infrastructure